THE INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS OF BANGLADESH
CMA JUNE, 2017 EXAMINATION
PROFESSIONAL LEVEL-I
SUBJECT: 101. INTERMEDIATE FINANCIAL ACCOUNTING

Reading Time: 15 minutes
Time: Three hours — Full Marks: 100

- ❖ All questions are to be attempted.
- ❖ Show computations, where necessary.
- ❖ Answer must be brief, relevant, neat and clean.
- ❖ Start answering each question from a fresh sheet.

Q. No. 1

(a) Briefly state the four "Enhancing qualitative characteristics, envisaged in the conceptual framework for Financial Reporting" of IASB.

(b) Presented below are three different transactions related to materiality. Explain whether you would classify these transactions as material.

(i) **Max Co.** has reported a positive trend in earnings over the last 5 years. In the current year, it reduces its bad debt allowance to ensure another positive earnings year. The impact of this adjustment is equal to 3% of net income.

(ii) **Swan Heights Ltd.** has an extraordinary gain of Tk.31,00,000 on the sale of plant assets and a Tk.33,00,000 loss on the sale of investments. It decides to net the gain and loss because the net effect is considered immaterial. Swan Heights Co.'s income for the current year was Tk.100,00,000.

(iii) **Modena Co.** expenses all capital equipment under Tk.5,00,000 on the basis that it is immaterial. The company has followed this practice for a number of years.

(c) Presented below is summarized information for **Walton Company Ltd**., which sells merchandise on the installment basis.

	2014	**2015**	**2016**
Sales (on installment plan)	Tk.2,63,158	Tk.2,60,000	Tk.2,80,000
Cost of sales	1,55,000	1,63,800	1,82,000
Gross profit	95,000	96,200	98,000
Collections from customers on:			
2014 installment sales	75,000	1,00,000	50,000
2015 installment sales		1,00,000	1,20,000
2016 installment sales			1,00,000

Instructions:

(i) Compute the realized gross profit for each of the years 2014, 2015, and 2016.

(ii) Prepare all entries required in 2016, applying the installment-sales method of accounting. (Ignore interest charges.)

(d) Bilal Limited, a Client of your consulting firm, has approached you with the following question regarding inventory:

(1) Fabric included in year- end inventory includes fabric being shipped from USA on FOB terms (risks and rewards are therefore transferred on date of shipment from the foreign harbour). Delivery costs associated with this special fabric are excessive (Tk.50,000 more than normal delivery costs), but are required urgently for seamless production. Can this Tk. 50,000 be included in the inventory value at year end?

(2) The company used a consultant to design new baggies (a completely new product with which the company has no experience), at a total cost of Tk.30,000. This was a once-off order for a large surf store chain. The baggies were completed by year end at a total production cost of Tk.5,00,000. Can the consultant's fees be included in the inventory valuation?

(3) Fabric X used in production of the T-Shirts, is valued at Tk.50 per metre, but can only be sold at Tk.35 per metre. Finished T-Shirts are expected to sell for Tk.100 and Tk.37 to produce. At what value should Fabric X be recognised in the financial statements?

Instructions:

Respond briefly to all the above queries of your client in accordance with IAS 2.

[Marks: (4+4+6+6) = 20]

Q. No. 2

(a) Explain how underwriting costs and accounting and legal fees associated with the issuance of stock should be recorded.

(b) Swarten Corporation reported the following amounts in the stockholders' equity section of its December 31, 2016, balance sheet.

Preferred stock, 10%, Tk.10 par (100,000 shares authorized, 20,000 shares issued)	Tk. 200,000
Common stock, Tk. 5 par (100,000 shares authorized, 20,000 shares issued)	Tk.100,000
Additional paid-in capital	Tk. 125,000
Retained earnings	Tk. 450,000
Total	Tk.875,000

During 2017, Swarten took part in the following transactions concerning stockholders' equity.

(1) Paid the annual 2016 Tk.1 per share dividend on preferred stock and a Tk.2 per share dividend on common stock. These dividends had been declared on December 31, 2016.

(2) Purchased 1,700 shares of its own outstanding common stock for Tk.40 per share. Swarten uses the cost method.

(3) Reissued 700 treasury shares for land valued at Tk.30,000.

(4) Issued 5000 shares of preferred stock at Tk.10.5 per share.

(5) Declared a 10% stock dividend on the outstanding common stock when the stock is selling for Tk.45 per share.

(6) Issued the stock dividend.

(7) Declared the annual 2017 Tk. 1 per share dividend on preferred stock and the Tk. 2 per share dividend on common stock. These dividends are payable in 2018.

Instructions

(i) Prepare journal entries to record the transactions described above.

(ii) Prepare the December 31, 2017, stockholders' equity section. Assume 2017 net income was Tk. 500,000.

[Marks: (5+15) = 20]

Q. No. 3

The following statement was prepared by Partex Textiles Ltd.'s accountant.

PARTEX TEXTILES LTD
STATEMENT OF SOURCES AND APPLICATION OF CASH
FOR THE YEAR ENDED SEPTEMBER 30, 2014

Sources of cash	
Net income	Tk.1,11,000
Depreciation and depletion	70,000
Increase in long-term debt	1,79,000
Changes in current receivables and inventories, less current liabilities (excluding current maturities of long-term debt)	14,000
	Tk.3,74,000
Application of cash	
Cash dividends	Tk. 60,000
Expenditure for property, plant, and equipment	2,14,000
Investments and other uses	20,000
Change in cash	80,000
	Tk.3,74,000

The following additional information relating to Partex Textiles Ltd. is available for the year ended September 30, 2014.

Q. No. 3 (cont'd……)

1. Salaries and wages expense attributable to stock option plans was Tk.25,000 for the year.

2. | | |
   |---|---|
   | Expenditures for property, plant, and equipment | Tk.2,50,000 |
   | Proceeds from retirements of property, plant, and equipment | 36,000 |
   | Net expenditures | Tk.2,14,000 |

3. A stock dividend of 10,000 shares of Partex Textiles Ltd. common stock was distributed to common stockholders on April 1, 2014, when the per share market price was Tk.7 and par value was Tk.1.
4. On July 1, 2014, when its market price was Tk.6 per share, 16,000 shares of Partex Textiles Ltd. common stock were issued in exchange for 4,000 shares of preferred stock.

5. | | |
   |---|---|
   | Depreciation expense | Tk. 65,000 |
   | Depletion expense | 5,000 |
   | | Tk. 70,000 |

6. | | |
   |---|---|
   | Increase in long-term debt | Tk.6,20,000 |
   | Less: Redemption of debt | 4,41,000 |
   | Net increase | Tk.1,79,000 |

Instructions

(i) In general, what are the objectives of a statement of the type shown above for Partex Textiles Ltd.? Explain.

(ii) Identify the weaknesses in the form and format of Partex Textiles Ltd.'s statement of cash flows without reference to the additional information. (Assume adoption of the indirect method.)

(iii) For each of the six items of additional information for the statement of cash flows, indicate the preferable treatment and explain why the suggested treatment is preferable.

[Marks: (4+4+12) = 20]

Q. No. 4

(a) Why does the accounting profession make a distinction between internally created intangibles and purchased intangibles?

(b) On January 1, 2016, **Orion Co.** acquired production equipment in the amount of Tk.5,00,000. The following additional costs are incurred:

Delivery costs	Tk.38,000
Installation costs	24,500
General administration costs of an indirect nature	3,000

The installation and setting –up period took three months, and an additional Tk. 21,000 was spent on costs directly related to bringing the asset to its working condition. The equipment was ready for use on April 1, 2001.

Monthly managerial reports indicated that for the first five months, the production quantities from this equipment resulted in an initial operating loss of Tk.15,000 because of small quantities produced. The months thereafter showed much more positive results.

The equipment has an estimated useful life of 14 years and a residual value of Tk.25,000. Estimated dismantling costs are Tk.15,000.

As per **IAS-16**, what is the cost of the asset and what are the annual charges in the Statement of Comprehensive Income related to the consumption of the economic benefits embodied in the assets?

(c) On December 31, 2015, Anjuman Inc. has a machine with a book value of Tk. 940,000. The original cost and related accumulated depreciation at this date are as follows.

Machine	Tk.1,300,000
Accumulated depreciation	360,000
Book value	Tk. 940,000

Depreciation is computed at Tk.60,000 per year on a straight-line basis.

Q. No. 4 (cont'd……)

Instructions

Presented below is a set of independent situations. For each independent situation, indicate the journal entry to be made to record the transaction. Make sure that depreciation entries are made to update the book value of the machine prior to its disposal.

(i) On April 1, 2016, Anjuman sold the machine for Tk.1,040,000 to Avanti Company.

(ii) On July 31, 2016, the company donated this machine to the Mountain King City Council. The fair value of the machine at the time of the donation was estimated to be Tk.1,100,000.

(iii) A fire completely destroys the machine on August 31, 2016. An insurance settlement of Tk.430,000 was received for this casualty. Assume the settlement was received immediately.

[Marks: (3+8+9) = 20]

Q. No. 5

(a) On December 31, 2015, Faital Company acquired a machine from Plato Corporation by issuing a Tk.600,000 zero-interest-bearing note, payable in full on December 31, 2019. Faital Company's credit rating permits it to borrow funds from its several lines of credit at 10%. The machine is expected to have a 5-year life and a Tk.70,000 salvage value.

Instructions:

(i) Prepare the journal entry for the purchase on December 31, 2015.

(ii) Prepare any necessary adjusting entries relative to depreciation (use straight-line) and amortization (use effective-interest method) on December 31, 2016.

(iii) Prepare any necessary adjusting entries relative to depreciation and amortization on December 31, 2017.

(b) On January 1, 2004. Best Way Company issued a Tk.12,00,000, 5-year, Zero-interest-bearing note to NRB Bank. The note was issued to yield 8% annual interest. Unfortunately, during 2005, Best Way fall into financial trouble due to increased competition. After reviewing all available evidence on December 31, 2005, NRB Bank decided that the loan was impaired. Best Way will probably pay back only Tk.8,00,000 of the principal at maturity.

Required:

(i) Prepare journal entries for both Best Way Company and NRB Bank to record the issuance of the note on January 1, 2004.

(ii) Assuming that both Best Way Company and NRB Bank use the effective interest method to amortize the discount, prepare the amortization schedule for the note.

(iii) Under what circumstances can NRB Bank consider Best Way's note to be "impaired".

(iv) Compute the loss NRB Bank will suffer from Best Way's financial distress on December 31, 2005. What journal entries should be made to record this loss?

[Marks: (10+10) = 20]

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